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Application of California-American Water Company (U 210 W), to Decrease Revenues for Water Service in its Coronado District by (\$73,100) or (0.46%) in 2008 and Increase Revenues by \$266,200 or 1.67% in 2009 and \$260,900 or 1.61% in 2010	A.07-01-036
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Application of California-American Water Company (U 210 W), to Increase Revenues for Water Service in its Village District by \$1,537,300 or 7.43% in 2008, \$243,400 or 1.08% in 2009, and \$232,900 or 1.02% in 2010	A.07-01-039

OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES

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SUMMARY OF RECOMMENDATIONS

In accordance with Rule 13.11 of the California Public Utilities Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates submits the following Summary of Recommendations for the contested issues in the General Rate Case of California-American Water Company ("Cal Am").

- Cost of Capital
 - Rate of Return
 - DRA recommends a rate of return 7.77% for test year 2008 and 7.80% for years 2009 and 2010, while Cal Am requests 8.42%, 8.44% and 8.43% for 2008, 2009 and 2010 respectively.
 - Return on Equity
 - DRA recommends a return on equity of 9.96% for 2008-2010, while Cal Am requests a return on equity of 11.50% for 2008-2010.
- Special Request #1 – Infrastructure Replacement Surcharge ("ISRS")
 - DRA recommends the Commission reject Cal Am's request for an ISRS.
- Special Request #3 – Rate Consolidation
 - DRA recommends the Commission reject Cal Am's request to consolidate the Sacramento and Larkfield districts.
- Administrative and General Expenses ("A&G")
 - Employees Pensions and Benefits
 - DRA requests that the Commission adopt DRA's recommended amounts for Employees Pensions and Benefits for all four districts in this proceeding.
 - Regulatory Expenses
 - DRA requests that the Commission adopt DRA's recommended amounts for Regulatory Expenses for all four districts in this proceeding.

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U 210 W), to Decrease Revenues for Water Service in its Coronado District by (\$73,100) or (0.46%) in 2008 and Increase Revenues by \$266,200 or 1.67% in 2009 and \$260,900 or 1.61% in 2010	A.07-01-036
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OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES

I. INTRODUCTION

Pursuant to Rule 13.11 of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure ("Rules"), and the schedule set by Administrative Law Judge ("ALJ") Rochester, the Division of Ratepayer Advocates ("DRA") files this Opening Brief in the General Rate Case ("GRC") of California American Water Company ("Cal Am").

In the second phase of this proceeding, the Commission will be considering Cal Am's requests for a conservation rate design that includes a water revenue adjustment mechanism ("WRAM"), and full-cost balancing accounts for purchased water and purchased power.¹

After extensive settlement discussions, DRA and Cal Am reached agreement on many of the issues in this proceeding. DRA and Cal Am will serve a Proposed Settlement Agreement that resolves most of the issues in this GRC application with the exception of: 1) Cal Am's request to consolidate the rates of the Sacramento and Larkfield Districts; 2) a requested Infrastructure Replacement Surcharge ("ISRS"); 3) the appropriate Return on Equity ("ROE"); and 4) two categories of Administrative and General ("A&G") Expenses. This opening brief addresses these remaining contested issues.² As the record in this case shows, Cal Am has not met its burden of proof with regards to all elements of its requested rate increases.

II. AUTHORITY

All charges demanded or received by any public utility must be "just and reasonable." (Public Utilities Code Section 451.) Existing rates are presumed to be reasonable and lawful and a utility seeking to increase those rates has "...the burden of showing by clear and convincing evidence that it is entitled to such increase." (D.00-02-046.) The standard applicable to the approval of rate increases is "clear and convincing" evidence:

Clear and convincing evidence must be clear, explicit, and unequivocal. It should be so clear as to leave no substantial doubt, or sufficiently strong to demand the unhesitating assent of every reasonable mind. (Id.)

DRA reviewed Cal Am's application and conducted discovery during its analysis and review for this proceeding. In numerous areas, Cal Am's showing is

¹ See ALJ's May 1, 2007 Ruling.

² Silence on any issue should not be interpreted as assent.

inadequate. The deficiencies, inappropriate assumptions and other inadequacies of Cal Am's showing are discussed in detail below.

III. COST OF CAPITAL

DRA and Cal Am have settled all issues concerning cost of capital except for return on equity ("ROE").

A. Return on Equity

The legal standard for setting the fair rate of return has been established by the United States Supreme Court. In the Bluefield Water Works case, the Supreme Court stated that a public utility is entitled to earn a return upon the value of its property employed for the convenience of the public, and set forth parameters to assess a reasonable return. (Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia (1923) 262 US 679, 692-693.) That return should be:

...reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. (*Id.* at, 692-693.)

As the Supreme Court noted in that case, however, a utility has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. (*Id.*) In 1944, the Supreme Court again considered the rate of return issue in the Hope Natural Gas Company case affirming the general principle that, in establishing a just and reasonable rate of return, consideration must be given to the interests of both consumers and investors. (*See* Federal Power Commission v. Hope Natural Gas Company (1944) 320 US 591.)

As discussed below, the various rates of return sought by Cal Am in this case are neither just nor reasonable. On the other hand, DRA's recommended rates of return are supported by the facts, the law and the Commission's policies and practices, and should be adopted.

**B. DRA's Analysis Follows Commission Precedent
and Recommends a Reasonable Return on Equity**

DRA recommends an ROE of 9.96%, while Cal Am requests an ROE of 11.5% for 2008-2010.³ (Ex. 29, p. 1-1.) In order to determine the appropriate ROE for Cal Am, DRA performed a quantitative analysis and then assessed the level of business and financial risk faced by Cal Am.

1. Quantitative Analysis

In its quantitative analysis, DRA used two financial models, the Discounted Cash Flow ("DCF") and the Risk Premium ("RP"), to estimate investor's expected ROE for Cal Am. DRA applied both models to a group of comparable water utilities that were selected based on two criteria: (1) water operations account for at least 70% of the utility's revenues, and (2) the utility's stock is publicly traded. The comparable group is comprised of six companies: American States Water, California Water Service, Connecticut Water Service, Middlesex Water, Aqua America, and San Jose Water. (Ex. 29, p. 2-1 to 2-9.)

Furthermore, DRA's recommendation is consistent with the adopted ROEs in recent Commission decisions for water utility General Rate Cases ("GRC") where ROE was litigated. In the ten Class A water utility GRC decisions since 2003 where ROE was litigated and not settled, the Commission adopted, on average, a ROE of 9.99%, with the adopted ROEs ranging from 9.78% to 10.25% as shown in Table 1 below. DRA's recommended ROE of 9.96% is consistent with the ROEs adopted in those Commission decisions.

³ Shortly before evidentiary hearings, DRA discovered minor errors in its DCF analysis. Correcting for the errors produced a ROE figure of 9.85%. However, due to the late date of the discovery of the error, DRA will not change its recommendation of a 9.96% for ROE. DRA submitted the corrections as Exhibit 40 in the interest of full disclosure.

Table 1 – Litigated Return on Equity for Class A Water Utilities GRCs 2003-2007

Decision	Company	DRA Recommended ROE	Company Recommended ROE	Decision ROE
03-02-030	Cal American	9.97%	11.00%	10.25%
03-05-078	Suburban	9.04%	12.00%	9.84%
03-08-069	Apple Valley Ranchos	9.53%	12.00%	10.10%
03-12-039	Great Oaks	9.28%	10.95%	9.78%
04-03-039	So Cal Water	9.41%	12.45%	9.90%
04-05-023	Cal American	9.48%	11.20%	9.79%
04-07-034	San Gabriel	9.43%	12.25%	10.10%
05-12-020	Apple Valley Ranchos	9.85%	11.60%	10.15%
06-01-025	So Cal Water	9.35%	11.30%	9.80%
07-06-024	Valencia*	9.57%	11.75%	10.19%
PD	Cal American	9.69%	11.60%	10.00%
	Average	9.51%	11.65%	9.99%
Current proceeding	Cal American	9.96%	11.50%	

* Reflects a 60 basis point (0.6%) upward adjustment of the ROE due a small company risk premium.

C. Cal Am’s Revisions to the DCF Model are Improper and Without Merit

1. Cal Am’s Use of VS Growth in Calculating Sustainable Growth is Improper

Cal Am includes VS growth in formulating its DCF forecast. (Ex. 9, Tab 8, p. 16.) VS growth (also called SV growth) represents the external growth, and the increase or decrease in the book value per share resulting from the sales of common stock. (Ex. 29, p. 4-1.) DRA objects to Cal Am’s inclusion of VS growth in its analysis because the Commission has rejected the use of VS growth in calculating sustainable growth in a DCF analysis. (D.07-06-024, pp. 47-48, *footnote omitted*.)

Cal Am claims that a VS growth term is necessary in a DCF analysis when a company is not expected to issue shares at book value. (Ex. 9, Tab 8, p. 18.)

However, it is unnecessary to include VS growth in calculating sustainable growth because DRA's recommendations are based upon an average of DCF and RP models. The DCF model is market based, and uses both current and future stock prices. (Ex. 29, p. 2-2.) Thus, DRA's models already capture the effects of the higher stock prices. In addition, the use of analysts' forward looking forecasts of growth in its DCF model captures the effect of SV growth. (Id., p. 2-5.)

Furthermore, DRA calculates sustainable growth per the method discussed in The Cost of Capital – Estimating the Rate of Return for Public Utilities.⁴ (Id. at 2-4.) This method does not use VS growth as indicated in a recent Commission decision rejecting the use of VS growth:

We concur with DRA that SV growth should be excluded. It is not an item recognized by Kolbe and Read, the authors of the authoritative textbook on public utility cost of capital estimates. Although Valencia's expert speculates on the reasons why Kolbe and Read do not factor SV growth into their DCF model, we need only note that they do not. (D.07-06-024, pp. 47-48, *footnote omitted*.)

Therefore, consistent with its past practice and in recognition that increases in stock price are already incorporated into DRA's analytical technique, the Commission should reject Cal Am's use of VS growth in its DCF analysis.

2. The Commission Should Reject Cal Am's Equity Cost Comparisons with Gas and Electric Utilities

Cal Am submitted an equity cost analysis comparing the cost of equity for water utilities to that of gas and electric utilities. (Ex. 9, Tab 8, p. 11.) This comparison is inappropriate because of the vast differences between the gas, electric and water utility industries. Sufficient data is currently available on comparable water utilities to perform a reasonable cost of capital analysis.

⁴ The Cost of Capital – Estimating the Rate of Return for Public Utilities, by A. Lawrence Kolbe and James A. Read Jr., with George R. Hall, 1985, pp. 55, 99.

Additionally, the Commission has repeatedly rejected the use of gas utilities as a proxy to derive water utility equity cost estimates.

Although water, electric and gas utilities are regulated, significant differences exist between these industries and how they are regulated. In part, these differences relate to the nature and source of the commodity being supplied. Water utilities are governed by a different regulatory regime than gas and electric utilities because of a number of inherent differences between the commodities and markets involved. For example, retail water regulation is exclusively a state or local government responsibility, whereas both electricity and gas operate in an environment of complementary and (at times) overlapping federal and state regulation. Moreover, long distance transportation of water is inherently more difficult than moving either electricity or gas and water systems are typically not interconnected via large grid networks. In addition, water remains the purest (true monopoly) industry because there is essentially no opportunity for substitution or competition in water.

In accordance with long standing precedent, the Commission should not consider Cal Am's comparison of the cost of equity for water utilities to that of gas and electric utilities. This Commission has consistently endorsed a cost of equity analysis that considers only water utilities. Cal Am's comparison to gas and electric utilities runs contrary to this established precedent and sound regulatory practice.

A small sample of the Commission's statements follows:

- “We also find that natural gas rates of return are not relevant for Apple Valley [Water Company]. The cost recovery and market risks are totally dissimilar.” (See D.05-12-020, p. 11)
- “We find it disappointing that Cal Am has relied so heavily in its analysis on comparisons with gas utilities, a practice the Commission has repeatedly rejected in the past because water utilities are less risky.” (See D.04-05-023, p. 52.)

- “Due to the revenue recovery mechanisms in place for water utilities, we find that water utilities do not face the same overall risks as energy and telecommunications utilities.” (See D.92-01-025, p. 23.)
- “The Commission has repeatedly stated that water utilities should not be compared to companies in other industries.” (See D.07-06-024, pp. 48-49.)

Comparisons to gas and electric utilities are not appropriate due to the significant differences between the water, gas and electric utilities. The Commission has consistently rejected such comparisons in past decisions.

D. Financial and Business Risk

In addition to its quantitative analysis using the two market-based financial models described above, DRA also assessed the level of business and financial risk faced by Cal Am. In general, a company’s total risk is the combination of business risk and financial risk. Business risk refers to the uncertainty inherent in the projections of future operating income relating to the fundamental nature of the company’s business. For regulated utilities, business risk consists primarily of regulatory risk. Financial risk relates to the amount of debt in the capital structure; the larger the debt portion, the greater the financial risk. (Ex. 29, p. 3-1.)

Cal Am has a low business risk. The Commission provides all water utilities with a multitude of mechanisms that minimize regulatory risk and protect earnings from inflation and regulatory lags. These mechanisms include Balancing Accounts for Purchased Water, Purchased Power, and Pump Taxes; Memorandum Accounts for Catastrophic Events, Memorandum Accounts for Water Quality related issues, Memorandum Accounts for Safe Drinking Water Act compliance,

50% Fixed Cost Recovery, and Construction Work in Progress in rate base.⁵ (Ex. 29, p. 3-1.)

The Commission is only now beginning to address the fact that water utility ROEs do not necessarily reflect the reduction in risk inherent in these balancing and memorandum accounts. In D.05-07-022, the Commission stated that:

...CWS is protected through separate balancing accounts for purchased water, purchased power and pump taxes, and memorandum accounts for catastrophic events and waste contamination. The result of these protections is to reduce the risk that CWS faces with regard to its opportunity to earn its return on equity. Consequently, we expect that in future proceedings all of these existing and adopted protections against erosion of future earnings will be given their proper weight in the determination of risk and consequently return on equity. (D.05-07-022, 2005 Cal. PUC LEXIS 286, *27.)

A company's total risk (business risk plus financial risk) is indicative of its overall financial integrity and ability to attract capital. Standard & Poor's ("S&P") rating agency, for example, evaluates a company's total risk in order to assign a credit rating, which is a direct measure of a company's ability to attract capital. S&P's evaluation includes a subjective analysis of business risk, including such things as managerial quality and regulatory environment. A quantitative analysis is also done, which uses financial ratios to measure how a company can generate earnings and cash-flow to meet its debt obligations. (Ex. 29, p. 3-4.) A rating of "AAA" through "BBB" is considered "investment grade." Any rating lower than "BBB" is considered speculative and more susceptible to adverse circumstances or economic conditions.

⁵ Although DRA opposes Cal Am's request for an ISRS, DRA notes that if the Commission does grant the ISRS request, it should consider its effect on Cal Am's risk.

While S&P does not rate Cal Am, it does rate American Water Capital Corporation as an A- company. American Water Capital is an affiliate of the holding company that owns Cal Am, and they issue Cal Am's debt securities. Without question, Cal Am currently has the ability to attract capital. (Id. at 3-3.)

1. Cal Am's Proposed Leverage Adder is Unnecessary and Unjustified

As discussed in Exhibit 29, DRA's Report on the Cost of Capital, Cal Am seeks a 330 basis point adder to its ROE to reflect what Cal Am alleges to be increased financial risk because it is more leveraged than its sample group of water utilities. (Id. at 3-3.)

Cal Am Witness Reiker describes his rationale for a "leverage adder:"

My 10.7 percent market cost of equity estimate for the sample water utilities represents the return a typical investor requires for purchasing a share of stock in the average water utility, capitalized in terms of market value with approximately 31 percent debt and 69 percent equity. California American Water's regulatory capital structure has significantly more debt and reflects greater financial risk than that of the sample water utilities. Therefore, any estimate of the cost [of] equity which relies on market data for the sample water utilities must be adjusted to reflect the financial risk associated with California American Water's regulatory capital structure if it is to constitute a fair rate of return in this proceeding. (See Ex. 9, Tab 8, p. 31)

Mr. Reiker goes on to describe his method for determining the "effect of debt on a company's cost of equity." (Id. at 34.) He calculates that "California American Water's cost of equity is approximately 330 basis points *higher* than the cost of equity to [Cal Am's] sample water utilities," and concludes that this is an appropriate "financial risk adjustment." (Id. at 36.)

No upward adjustment to Cal Am's ROE is needed or appropriate. Cal Am does not have a problem attracting capital because it enjoys the good credit rating

(A-) of American Water Capital Corporation, the issuer of Cal Am’s debt securities. (Ex. 29, p. 3-3.) “[M]aintaining their current level of leverage in their capital structure is a decision under the company’s management control.” (Id.) Cal Am has the option of reducing its financial risk by dropping the percentage of debt in its capital structure to a level similar to that of the comparable group of water utilities. Any increased financial risk faced by Cal Am due to its capital structure is incurred by choice of Cal Am’s management.

Furthermore, the Commission has not recently adjusted ROEs based on the capital structure of a utility. The Commission has not authorized any upward ROE adjustments for water utilities whose capital structures have a high percentage of debt. Similarly, the Commission has not adjusted ROEs downward for utilities that maintain a high ratio of equity in their capital structure. Of late, DRA typically has not proposed any ROE adjustments based on capital structure. (DRA/Willis, 4 RT 301-302.)

However, in the past DRA has considered an “ROE incentive” to compensate a water company for its “practice of maintaining a higher a ratio of long-term debt to total capital.” (D.03-02-030, *mimeo*, at 61, *footnote omitted*.) The Commission has observed in such a case that:

Debt financing is less expensive for ratepayers than equity financing because debt interest is tax-deductible while common equity returns are not. The marginal cost of debt, however, also increases with increasing leverage, and the two effects tend to offset within a reasonable capital structure range. (Id. at 62, note 57.)

While DRA does not recommend a leverage adjustment in this proceeding, DRA acknowledges that there may be circumstances under which such an adjustment would be reasonable. However, Cal Am’s proposed leverage adjustment of 330 basis points is far beyond the range of the leverage adjustment considered in past Commission decision. In a GRC for Cal Am’s Monterey District, for example, DRA did propose an “ROE incentive” – in the form of an

adder of only 22 basis points. (Id. at 61.) Cal Am supported DRA's proposed 22 point adjustment as an appropriate adder to the calculated ROE and did not propose an alternative adder. (Id. at 66.)

Cal Am has not proffered any evidence for proposing an ROE adder in this case that is 308 basis points higher than what was recently proposed for another one of its California districts. Given the lack of justification or evidence supporting Cal Am's 330 basis points risk adjustment, the Commission should reject the request as unnecessary and wildly disproportionate to Cal Am's actual risk profile.

2. Effect of a Water Revenue Adjustment Mechanism on ROE

Conservation rate design issues including Cal Am's requests for a Water Revenue Adjustment Mechanism ("WRAM"), inverted block rate structure and Full Cost Balancing Account will be addressed in the second phase of this proceeding.⁶ The Commission should consider reducing Cal Am's ROE if a WRAM is authorized because of the reduction in risk provided by a WRAM. (Ex. 29, p. 3-2 to 3-3.)

However, DRA recommends considering this issue as part of the Order Instituting Investigation ("I.") 07-01-022 to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities. The scope of I.07-01-022 has been amended so that the impact of a WRAM on ROE will be considered in Phase 1B.⁷ According to the scoping memorandum I.07-01-022 will address the effect of a WRAM on the ROEs of California Water Service Company, Suburban Water Company, Park Water Company, Golden State Water Company and San Jose Water Company. (I.07-01-022, pp. 3-4.) Since the Commission is already addressing this issue with regards to five of the nine Class

⁶ Ruling 5/1/07, at

⁷ Administrative Law Judge's Ruling Consolidating Application of the San Jose Water Company, Modifying Schedule and Addressing Phase 1 Hearings, 5/29/07.

A water utilities, it is appropriate that I.07-01-022 considers this issue with regards to Cal Am as well.

IV. SPECIAL REQUEST # 1 – INFRASTRUCTURE REPLACEMENT SURCHARGE

A. Introduction

Cal Am has requested an Infrastructure Replacement Surcharge (“ISRS”). Cal Am’s proposed ISRS plan would initiate a broad-scale infrastructure replacement program funded by a special ratepayer surcharge. Cal Am seeks authority to make infrastructure improvements without prior Commission authorization, and proposes to seek cost recovery through an increasing surcharge (capped at a maximum rate increase of 10% over three years) that will compensate Cal Am for certain fixed costs related to capital projects that have been completed. Cal Am’s proposal limits reasonableness reviews of these ISRS expenditures to an after-the-fact examination in the next GRC.

DRA urges the Commission to reject Cal Am’s request for an ISRS at this time. The purpose of the ISRS is to establish a funding mechanism to finance the systematic replacement of the infrastructure in the four districts in this GRC. ISRS primarily benefits Cal Am, while exposing its ratepayers to unnecessary risk. Although DRA supports the goal of a prudent infrastructure replacement strategy, the proposed ISRS is merely one possible ratemaking tool. The current regulatory framework provides alternatives that satisfy the needs of Cal Am, while protecting ratepayers from the significant risks posed by ISRS. Given the ratemaking alternatives available and the lack of a comprehensive, long-term strategy for Cal Am’s infrastructure replacement, Cal Am has not established that implementing ISRS is appropriate at this time.

B. The Water Action Plan does not mandate an ISRS

One of Cal Am’s justifications for its ISRS request is that the Water Action Plan (“WAP”) “suggests that a distribution system infrastructure charge (“DSIC”) (or ISRS) program may be beneficial to ratepayers.” (Ex. 9, Tab 9, pp. 12.) The

second action of the third objective of the WAP does call for *consideration* of “authorization of a Distribution System Improvement Charge to promote infrastructure improvements.” (WAP, p. 4.) However, the text of the WAP does not specifically endorse ISRS as a ratemaking mechanism nor does it state that this ratemaking mechanism would be beneficial to ratepayers. Rather its primary beneficiary would be the water utility. An ISRS will not provide any additional benefits to ratepayers that are not available under the current regulatory framework.

It must first be noted that the WAP is a guideline, not the product of a Commission decision or resolution. The WAP does not establish policy, rather it identifies major policy issues concerning the regulation of investor owned water utilities and suggests possible solutions. The purpose of the WAP is to initiate a process where the Commission explores “innovative solutions” to these major policy issues. (Id at 3.) This is evidenced by the ongoing Order Instituting Investigation (“OII”) I.07-01-022, which was initiated in response to proposals to achieve the second objective of the WAP. Furthermore, the WAP merely indicates that it will “consider” a DSIC, not mandate the implementation of one. (Id.)

The WAP does **not** suggest that ISRS may be “beneficial to the ratepayers.” (Ex. 9, Tab 9, p. 12.) The WAP indicates that a DSIC will:

[P]rovide further incentive for water utilities to finance capital improvements, we will consider creating a Distribution System Improvement Charge, which will isolate this revenue stream from other uses. This clearly identified and separate rate component will enable water utilities to more efficiently dedicate sufficient revenue for infrastructure improvements. (WAP, p. 12.)

This language implies that DSICs are useful because they will motivate and provide incentives to water utilities to replace their infrastructure when it reaches the end of its useful life, a task that is a normal component of the utility’s on-going

responsibilities. ISRS provides significant benefits for the utility while offering scant rewards to its customers. In effect, affording the following benefits to Cal Am: easing the utility's burden in rate cases; giving the utility overly broad discretion; allowing a utility to increase rates up to 10% with vastly reduced regulatory oversight; decreasing the incentive of the utility to trim costs on ISRS projects; having the potential to reduce regulatory lag and risk; and increasing the likelihood that costs that DRA and the Commission would normally disallow will be allowed through the surcharge.

Thus, ISRS affords tremendous advantages to the utility. Ratepayers may benefit from new infrastructure, but any benefit is secondary and implicit and is available under the current regulatory framework without the unnecessary risks and possible excess costs that accompany an ISRS framework.

C. The Alleged Benefits of an ISRS are Illusory

1. The flexibility Cal Am seeks equates to reduced regulatory oversight

Cal Am claims that an ISRS will provide it with more flexibility to plan for and complete infrastructure replacement projects. (Ex. 8, Tab 2, p. 16.) DRA disputes that an ISRS is necessary since the current regulatory framework provides the requisite flexibility to address Cal Am's needs.

Cal Am asserts that it requires flexibility in its infrastructure replacement spending because it is difficult to make accurate forecasts regarding the timing for replacing infrastructure since many of the projects are short term or emergency in nature. (Id. at 17.) However, the flexibility to deal with the emergency projects already exists under the current regulatory framework. Under the current framework, Cal Am has budgeted amounts under specific recurring line items that can be used to handle emergencies. (Cal Am/Schubert, 5 RT 310.) Cal Am has a record of past emergency projects and uses this record to forecast a budget estimate for emergency projects such as main breaks. (Id.) Cal Am has not clearly demonstrated why this forecasted expense is not sufficient for its needs.

Additionally, Cal Am claims that an ISRS will “add a level of flexibility in planning for and completing vital construction projects that does not currently exist.” (Ex. 8, Tab 2, p. 18.) This argument is troubling given Cal Am’s present lack of a specific strategy to replace the infrastructure of its water systems. (Ex. 9, Tab 2, p. 20; Cal Am/Schubert 5 RT 319.) Cal Am seems to be advocating a process where they respond reactively to the situations rather than developing a detailed and aggressive strategy to replace their infrastructure. The “flexibility” Cal Am covets is more akin to a reduction in regulatory oversight.

2. Massive infrastructure replacement needs not quantified

Cal Am repeatedly characterizes the need for infrastructure replacement in its districts as “massive” or “critical.” (Ex. 9, Tab 9, p. 20; Ex. 8, Tab 2, p. 22.) However, Cal Am has not provided the necessary evidence to demonstrate the size of its infrastructure replacement problem. (Ex. 25, p. 11-11.) Rather Cal Am’s witnesses use alarmist words such as “massive” and “critical” without pointing to specific problems it will face regarding the infrastructure of its water systems.

Cal Am further supports its claim that an ISRS is warranted by pointing out that the water and wastewater industry in the United States face a “massive capital investment required to meet current and future water quality and infrastructure requirements.” (See Ex. 43.) Although the United States as a whole and certain water systems in the United States may require “massive” infrastructure replacement needs, this does necessarily indicate that California or Cal Am’s water systems in particular, face such a challenge.⁸ (DRA/Steingass, 5 RT 377.)

Cal Am has not quantified the nature of its own infrastructure replacement challenge, making it difficult to judge the extent or the urgency of the

⁸ While age of facilities is only one of many criteria to use in forecasting infrastructure needs, California, in some water districts, has a different situation than other parts of the country. California subdivisions vary in age, but in some cases the facilities are younger, often built post WWII or even more recently. Additionally, significant numbers of cast iron main breaks are especially more prevalent in the areas of the country that experience below-freezing cold winter weather.

infrastructure replacement problem.² Just because an ISRS may be appropriate for certain areas in the United States, does not mean it should be implemented in California without detailed information. Cal Am has not proffered sufficient information to the Commission for it to determine what rate of infrastructure replacement will be adequate or aggressive enough to ensure that safe and reliable service can be maintained. In addition, Cal Am has not provided a detailed capital budgeting proposal that would allow the Commission to determine the amount of capital investment to authorize. Finally, the Commission has incomplete information to determine whether to grant an alternative ratemaking mechanism such as ISRS or whether the existing one is sufficient.

Additionally, many “policies and mechanisms” exist besides an ISRS that can “help ensure sustainable practices in promoting needed capital investment and cost-effective rates.” (Ex. 43, p. 1.) The NARUC *Resolution Supporting Consideration of Regulatory Policies Deemed as “Best Practices”* identifies many possible “policies and mechanisms”:

a) the use of prospectively relevant test years; b) the distribution system improvement charge; c) construction work in progress; d) passthrough adjustments; e) staff-assisted rate cases; f) consolidation to achieve economies of scale; g) acquisition adjustment policies to promote consolidation and elimination of non-viable systems; h) a streamlined rate case process; i) mediation and settlement procedures; j) defined timeframes for rate cases; k) integrated water resource management; l) a fair return on capital investment; and m) improved communications with ratepayers and stakeholders. (Id.)

The Commission already utilizes nearly every policy or mechanism identified in the list above. These policies and mechanisms provide Cal Am with the opportunity to satisfy their needs as to infrastructure replacement without an ISRS.

² For example, Cal Am did not bother to articulate what is the specific nature of its infrastructure nor the amount of capital investment that will be necessary.

3. Benefits of a dedicated revenue stream are questionable

One reason that Cal Am has proposed an ISRS is “[t]he need for a dedicated revenue stream to be exclusively used to offset a portion of the fixed costs of capital additions made to replace existing facilities.” (Ex. 9, Tab 9, p. 11.) Cal Am claims that a “dedicated revenue stream” will improve its current “financial planning” processes and enable it to “develop a more comprehensive program to replace existing facilities.” (Id. at 12.)

When an ISRS is authorized, financial plans for the allocation of funds for capital expenditures to replace existing infrastructure facilities will also identify associated ISRS surcharge revenue streams. As a result, all revenue calculations will be more accurate and predictable. (Id. at 13.)

As a result of improved revenue forecasting, better estimates of funds available to offset a portion of additional fixed costs of capital additions to replace existing facilities can be determined. The ability to add this level of precision to the financial planning process as a result of implementing ISRS will enable California American Water to improve its entire decision-making process for the allocation of funds for all capital improvement programs. (Id. at 13.)

However, it is unclear how Cal Am’s ISRS proposal will provide more “accurate and predictable” revenue calculations compared to traditional ratemaking. (Id.) An ISRS is unlikely to affect other potential variations due to weather, consumption, etc. It is just a different way of collecting from customers. The ISRS surcharge is merely a percentage, separate from rates that will increase on a quarterly basis throughout the three years of a general rate case cycle as Cal Am actually completes ISRS projects.

Under the current regulatory framework, ISRS eligible projects are counted in rate base, and the Commission adopts base rates to create a “revenue stream” that accounts for ISRS eligible projects as well as non-ISRS eligible projects.

Therefore, under the current regulatory framework Cal Am will know what its base rates will be for the next three years. However with an ISRS, Cal Am has a *less* predictable revenue stream because it can only speculate as to when it will complete projects, and completion of projects is what would trigger a surcharge and subsequent increases to that surcharge.

4. Assuring customers that infrastructure is being replaced is a solution in search of a problem

Cal Am argues that an ISRS is needed to assure customers that a portion of their monthly bills is being used for such infrastructure replacement. (Id. at 11.) This appears to be a “solution” in search of a problem. Although Cal Am cites customer concern as a reason for an ISRS, it has not demonstrated that customers actually have significant concerns about the general condition of their water systems or that a separate surcharge for ongoing infrastructure replacement would provide reassurance.

Customers attending the Public Participation Hearings (“PPHs”) did not give Cal Am’s ISRS proposal any special attention or indicate that it would resolve any concerns. The lone customer comments regarding ISRS were those of Mr. Stan Wirth at the Sacramento PPH. His concerns were:

When I opened the envelope and saw what the rate increase was, first thing I went to, I said, what are they doing, because I know when we were under Citizens Utilities when we switched over to Cal American, rates went up significantly then, and now they're going up significantly one more time. Looking at the first item, it said: "Implementation of infrastructure replacement surcharge." So my question was, what did they do with the other money? I mean they've already gotten a significant amount. Do they have a long-term plan? It doesn't sound like it. It sounds like they're doing it as something shows up. If you had a long-term plan, you wouldn't need these kinds of rate increases. So that bothered me a little bit. (PPH, 3 RT 123-124.)

How much is infrastructure that they haven't done that they put off? They got a large rate increase. What happened with that? Here is another large rate increase. I mean how many more have we got coming? It seems like there's not a lot of planning involved. If there is, we sure can't see it and it doesn't appear to be that way. (PPH, 3 RT 125.)

Mr. Wirth's comments go exactly to the point that Cal Am has not specifically forecasted their long term infrastructure needs or the long term effect of those needs on rates. With an infrastructure replacement strategy, even simply one with an "order of magnitude" level of detail, the Commission would be in a better position to know what to authorize regarding a special mechanism or whether to use existing ratesetting mechanisms.¹⁰

5. Reduction in base rates is a moot argument

Cal Am also points to components of its proposed ISRS that will benefit or safeguard ratepayers such as a reduction in base rates. It is disingenuous to emphasize that an ISRS will reduce base rates. While factually true, it is a virtually meaningless argument from a ratepayer's point of view. A customer's bill may appear more palatable at the beginning of a rate case cycle if base rates do not reflect upcoming ISRS projects. Right after the first quarter, however, the customer's bill will begin to reflect an erratic, yet ever increasing, surcharge. The predictability and reliability of overhead expenses that businesses crave is also applicable to the personal household expenses of residential ratepayers; as energy and other costs escalate, the more important predictability becomes.

¹⁰ Identifying the populations and vintages of infrastructure (cast iron, ductile steel, cement asbestos) that are nearing the ends of their useful lives, estimating the number of facilities (wells, treatment facilities, pumps, services, valves, meters) and miles of pipe to replace, forecasting the funding needed. (Ex. 25, p. 11-13 to 11-14.)

6. Mitigation of the impact of the reduction in per-customer sales a non-issue

Cal Am also contends an ISRS is needed to mitigate the “impact of a reduction in per-customer sales as related to funding a portion of the fixed cost of capital projects to replace existing facilities.” (Ex. 9, Tab 9, p. 11.) Cal Am’s contention makes no sense since reduced consumption will not impact funding for ISRS-type projects any more than funding for other capital projects. It is unclear why this should be a special consideration in favor of an ISRS. Furthermore, Cal Am has also proposed a Water Revenue Adjustment Mechanism (“WRAM”) that would purportedly compensate it for any conservation-induced future sales reductions.

D. Risks associated with ISRS

Cal Am claims that ISRS will benefit ratepayers. However, ISRS presents significantly more risks to ratepayers than benefits.

1. A 10% cap is excessive

Cal Am’s ISRS proposal includes a “price cap” that limits the surcharge to 10% of the adopted revenue requirement over a three year period. If an ISRS is adopted, a surcharge cap would be crucial. However, the cap proposed by Cal Am is significantly higher than those used in other states. (Ex. 25, p. 11-23.) In particular, Pennsylvania, whose DSIC served as a model for Cal Am’s ISRS proposal, set the surcharge cap at 5%. (Ex. 8, Tab 2, p. 6.) This figure amounts to about 2-1/2 percent per year since the companies proposing the DSIC were filing rate cases every two years. (Cal Am/Harrison, 5 RT 336.)

Cal Am has not provided a justification for the 10% cap other than it was a figure company officers were “comfortable with.” (Id. at 337.) Cal Am’s 10% cap amounts to about 3-1/3% per year. (Id. at 332.) However, Pennsylvania American’s proposal of 2-1/2% was based on the rate of inflation. (Id. at 336.) Cal Am has not demonstrated why its higher 10% cap is necessary or appropriate. It should be noted that 10% of an adopted revenue requirement represents a

substantial amount. This is far too large an amount to be collected through an ISRS, particularly through an ISRS framework that will reduce regulatory oversight.

2. Cal Am's expedited advice letter process is problematic

Cal Am proposes an advice letter process limited to 15 days for approval of the ISRS surcharge. This proposal represents a *de facto* carte blanche for regulatory approval and is palpably deficient in adequate regulatory safeguards. Fifteen days is manifestly insufficient time for a thorough review of a surcharge proposal and is infeasible with current Commission staff resources.

Although Cal Am claims that review of the surcharge requests will require only a “minimal” amount of time, the time needed to conduct a thorough review will still be considerable. The amount Cal Am will collect through an ISRS will not be trivial. 15 days does not provide enough time for Water Division and DRA to conduct a careful review of the surcharge requests.

Furthermore, Cal Am has not explored if the Commission's Water Division has the staff resources to process the large amount advice letters that will result from an ISRS program. For each district, Cal Am could file quarterly Advice Letters. This could result in the Commission processing 36 Advice Letters per year from Cal Am alone. If all the Class A water companies regulated by the Commission utilized an ISRS framework similar to Cal Am's, the Commission could be processing 228 Advice Letters per year.¹¹

3. After-the-fact review is risky for ratepayers

Under Cal Am's ISRS proposal, a reasonableness review of the eligible projects by the Commission and DRA would not occur until after the project is completed and would take place in the next GRC. Cal Am would begin recovering its investments on the ISRS projects as soon as they were finished.

¹¹ There are nine Class A water utilities in California. Those nine Class A utilities have 57 districts. (D.07-05-072, p. A-17.)

(Ex. 9, Tab 9, p. 15.) Cal Am's ISRS proposal removes effective regulatory oversight over ISRS eligible projects by shifting review until after a project is completed.

Under the current regulatory framework, DRA carefully reviews project proposals and evaluates their relative need before a project is completed. Careful scrutiny prior to completion is effective and often results in a significant reduction in rates due to the elimination or scaling back of projects. For example, in the proposed settlement for the Village district, Cal Am and DRA agreed to a figure of \$2,758,300 for gross plant additions which was 23% lower than initially proposed. Overall, the proposed settlements between Cal Am and DRA provide for gross plant additions that are about 34% lower than the original utility proposal as seen below in Table 2.

Table 2 – Summary of Proposed Settlement for Gross Plant Additions

	2008 & 2009	2008 & 2009		
	DRA	Utility	Settlement	% Difference
	Recommended	Proposed		
Coronado	\$ 1,856,933	\$ 4,445,709	\$ 4,152,400	-7%
Larkfield	\$ 823,202	\$ 4,778,202	\$ 751,200	-84%
Sacramento	\$ 9,200,190	\$24,297,590	\$14,950,200	-38%
Village	\$ 6,525,250	\$10,031,250	\$ 8,897,500	-11%
Totals	\$ 18,405,575	\$43,552,751	\$28,751,300	-34%

Cal Am argues that DRA and the Commission will retain their full authority to engage in a prudency review under an ISRS framework, claiming the only difference is that the review is done after the fact. (Ex. 9, Tab 9, p. 19.) Cal Am maintains regulatory oversight is actually increased under an ISRS framework because projects would be reviewed once they are completed. (Ex. 23, p. 17.) If a project included imprudent costs, the Commission could adjust already incurred expenditures by removing imprudent cost from ratebase.¹² (Id. at 20.) It claims

¹² This remedy does not account for the money that ratepayers have already paid through the ISRS surcharge as soon as the project involving the imprudent costs was completed.

that the current process allows for less effective review because the project has not been completed.

Cal Am's argument is unconvincing. Once a project is completed, a utility will not have the flexibility to change its position. Recovery of project costs becomes an "all or nothing" proposition since the utility has already spent the money and will suffer financial harm from partial or no recovery. However, if review is done before a project is completed, both DRA and a utility have the flexibility to alter their positions since the utility has little invested and can change the design or scope of the project. By contrast, once a project is complete Cal Am will have every incentive to vigorously push for full approval of project costs.

Additionally, after-the-fact review is problematic because it would be politically unpopular to disallow an imprudent expenditure. When asked her opinion as to whether the Commission might be less inclined to disallow expenditures after-the-fact, DRA Witness Steingass observed:

... I don't think they are going to "punish" the company by disallowing large sums of capital investment. It just wouldn't be a popular position for the Commission to take. And they would be loathe to take that move, I would think.
(DRA/Steingass, 5 RT 378.)

After-the-fact review is even more problematic in this situation since Cal Am has no long-term planning strategy in place for infrastructure replacement. Cal Am is essentially asking for a blank check for an unstructured and unplanned infrastructure replacement program that would only be subject to after-the-fact review.

4. Absence of a detailed plan is problematic

A detailed infrastructure replacement plan identifying the magnitude of Cal Am's infrastructure replacement needs and priorities is a logical prerequisite for the implementation of an ISRS program. However, Cal Am has not prepared a specific plan detailing how it will replace its infrastructure. (Ex. 9, Tab 9, p. 20.)

Having a detailed infrastructure replacement plan is important before an ISRS-like program is implemented. It will ensure that infrastructure replacement is carried out in a judicious and effective manner. A detailed infrastructure replacement plan should identify the age, condition, location, operating history or specific problem areas of the infrastructure that will be addressed by ISRS. (Ex. 25, p. 11-6.) Additionally, it should quantify the amount of infrastructure Cal Am expects to replace on a yearly basis and estimate how long the replaced infrastructure should serve the customers.¹³

Cal Am does not have a sufficiently detailed infrastructure replacement plan at this time and needs to do considerable work before a sufficient plan is available. (Cal Am/Schubert, 5 RT 315-316.) The absence of a detailed infrastructure replacement plan is another indication that Cal Am's ISRS proposal is premature and should be rejected.

E. Recommendations if the Commission Adopts an ISRS

Although DRA believes an ISRS is not necessary for Cal Am to effectively replace the infrastructure of its water systems, DRA recommends several modifications to Cal Am's proposal if an ISRS is authorized. Cal Am's current proposal does not allow for effective regulatory oversight.

DRA agrees with many of the changes to the ISRS proposal that were included in the Proposed Decision for Application ("A") 06-01-005, a proceeding where Cal Am requested authorization for a pilot ISRS program for its Los Angeles districts. These changes provide additional safeguards to ensure the Commission maintains effective regulatory oversight. The pilot program adopted in the Proposed Decision for A.06-01-005:

¹³ Other important information that should be in a detailed infrastructure replacement plan includes: a multiple year forecast quantifying the number of wells, water treatment plant, distribution mains, services and other facilities that may fall under an ISRS; criteria used to determine when facilities will need replacement; estimates or forecasts identifying the level of capital investment planned; the effect of national security or drinking water standards on infrastructure replacement. (Ex. 25, p. 11-6.)

- Adopts ISRS as pilot program subject to full review in next GRC, which based on the new Rate Case Plan, will be filed as of January 1, 2009 for rates going into effect on July 1, 2010. (Proposed Decision, A.06-01-005, p. 54.)
- Applies ISRS to specific infrastructure projects approved in the proceeding. (Id. at 55.)
- Caps the surcharge at 7% of annual adopted revenue requirement over a three year period. (Id. at 55.)
- Adopts a Tier 3 advice letter procedure requiring notice to all interested parties, a full protest period and requires a formal Commission resolution. (Id. at 55-56.)
- Requires that the capital asset planning process to explicitly address an infrastructure replacement strategy. (Id. at 56-57.)

Although the changes to the ISRS proposal that are established in the Proposed Decision provide additional safeguards, DRA recommends the following additional safeguards to ensure adequate regulatory oversight and protection of ratepayers:

- Require Cal Am to provide supporting documentation within the AL filing to allow Water Division and DRA to confirm projects were constructed and surcharge was calculated correctly.
- Require Cal-Am to pay customers interest on their refund if ISRS over-reovers.
- Provide customer notification (bill insert and public notice) before implementing DSIC so that customers are aware of the new line item on their water bill and what it is for.
- Strengthen accountability and goals of infrastructure replacement by requiring utility to supplement its annual report to the Commission with:
 - Planned vs. actual expenditures for the most recent year;
 - Planned vs. actual maintenance or construction performed with statistics such as wells rehabilitated, infrastructure replaced, etc.
 - Actual amounts of revenue collected per year via the DSIC/ISRS surcharge.

- Require an annual audit and reconciliation of the DSIC/ISRS surcharge.

Again, Cal Am's ISRS proposal is flawed and unnecessary at this time. However, if the Commission were to adopt an ISRS, it is vital that the changes identified above are included to ensure that the Commission maintains effective regulatory oversight and ratepayers are protected.

V. SPECIAL REQUEST # 3 – RATE CONSOLIDATION

A. Introduction

As part of its GRC application, Cal Am requests authorization to consolidate its Sacramento and Larkfield districts for ratemaking purposes. (Ex. 9, Tab 9, p. 38.) Cal Am previously requested authority to consolidate rates for its Sacramento and Larkfield districts in 2002 and 2004. On both occasions, the Commission denied Cal Am's consolidation requests. (D.04-05-023; D.05-09-020.)¹⁴ DRA recommends that the Commission deny Cal Am's consolidation again.

Cal Am has not justified its consolidation proposal for the Sacramento and Larkfield districts. Cal Am's consolidation proposal fails to satisfy DRA's 1992 Guidelines. Therefore, Cal Am has not made a prima facie case for consolidation. As a result, the burden of proof shifts back to Cal Am to prove that its consolidation proposal is in the public interest.

Cal Am has not satisfied this burden of proof. In particular, the consolidation proposal is not in the public interest because it: 1) breaks the link between rates and cost of service, a requirement set forth in Section 701.10(f) of the Public Utilities Code and 2) places an inequitable burden on ratepayers in the Sacramento district because they must pay higher rates to subsidize Larkfield district.

¹⁴ The Commission also denied a similar request by Cal Am's to consolidate the Felton and Monterey districts. (D.05-09-004.)

DRA disputes Cal Am's claim that D.00-06-075 supports its consolidation proposal because the situation in this GRC is not analogous to a case in which Southern California Water Company received authority to consolidate various districts into a region-wide tariff. The cases are distinguishable because in D.00-06-075 the Commission found there was a compelling need to assist ratepayers in an impoverished district. Larkfield is not an impoverished community.

Additionally, DRA disagrees with Cal Am's contention that the Water Action Plan supports its consolidation proposal. The WAP encourages policies that will subsidize high cost areas. However, other solutions offer a better approach to the affordability issue in Larkfield; solutions that are more targeted and equitable. Lastly, the Commission should deny Cal Am's request because public opinion in both the Sacramento and Larkfield districts is clearly against consolidation.

B. DRA Guidelines

In 1992, to reduce the workload of processing rate cases, DRA and the large water utilities jointly developed "Guidelines for Combining of Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes." (Application of Southern California Water Company for authority pursuant to Public Utilities Code § 454 to restructure water rates of its Barstow, Calipatria-Niland, Claremont, Desert, Orange County, San Dimas, San Gabriel and Wrightwood Districts into region-wide rates, D.00-06-075, 2000 Cal. PUC LEXIS 1114, *25.) The DRA Guidelines established four criteria to be considered when evaluating proposed consolidations: proximity, rate comparability, similar water supply, and, operations. (Id.) The DRA Guidelines also stated that districts should not be combined for the express purpose of subsidization. (Id.)

The intent of the DRA Guidelines was "to set criteria for single tariff pricing that, when met, establish *prima facie* reasonableness of the proposed consolidation." (Id. at *41.) When the DRA Guidelines are not met, there is no

prima facie reasonableness and thus the burden of showing that the consolidation is in the public interest falls upon the applicant. Cal Am's consolidation proposal fails to meet the DRA Guidelines and directly contravenes the condition that no districts should be combined for the express purpose of subsidization.

Cal Am acknowledges that its proposal to consolidate the Sacramento and Larkfield districts does not meet the DRA Guidelines' criteria and procedures for combining districts. (Ex. 9, Tab 9, p. 39.) However, Cal Am asserts that the DRA Guidelines no longer have any relevance. (Id.) Cal Am has not presented any convincing evidence to support its assertion that the DRA Guidelines are outdated. Since the Commission has used and relied on the DRA Guidelines to assess all water consolidation proposals since 1992, evidently the Commission still considers them to be relevant. No Commission decision, resolution or other document has found the DRA Guidelines to be outdated.

1. Cal Am's consolidation proposal fails to satisfy the four criteria of the DRA Guidelines for consolidation

a) Proximity

The DRA Guidelines state that districts to be consolidated must be within close proximity to each other. (D.05-09-004, 2005 Cal. PUC LEXIS 356, p.*10-11.) Districts within 10 miles of each other meet the proximity criterion. (Id.) Cal Am's consolidation proposal does not remotely satisfy the proximity criterion.

Not only are the Sacramento and Larkfield districts approximately 120 miles apart, but they are in different counties. (Ex. 26, p. 12-4.) Each district has separate field offices and operations and maintenance staff to serve its customers and to maintain and operate the respective water systems. Even with consolidation, Cal Am would have to maintain separate field offices and staff in order to reliably serve its customers.

In its testimony, Cal Am claims that the proximity criterion is no longer relevant in today's environment. (Ex. 9, Tab 9, p. 45.) However, proximity

remains highly relevant to cost of service. If two districts are in close proximity, they are more likely to share similar service cost characteristics because of commonalities in elevation, climate, physical terrain, age of infrastructure, and amount of rainfall. (DRA/Brooks, 4 RT 223.) Moreover,

Water is a scarce resource, like land. It is important that when people choose where to live and industry chooses where to locate that the true environmental costs be reflected in the costs of the land and water. If water is subsidized, more people will choose to live in unsustainable areas. Local control, environmental impacts and growth are intricately linked. Severing the link between rates and costs will adversely impact local land-use planning. The proximity criterion reflects more than the ability to remotely manage an area like an absentee landlord. (D.05-09-004, p. 10.)

Proximity is a valuable criterion when evaluating a consolidation proposal and remains relevant. Cal Am's consolidation proposal does not even approach satisfying this criterion since the Sacramento and Larkfield districts are 120 miles apart, far more than the suggested 10 mile maximum.

b) Rate Comparability

The DRA Guidelines state that present and projected future rates should be should be relatively close, with rates of one district no more than 25% greater than rates in the other district or districts. (D.05-09-004, p. 8.) Cal Am's proposed consolidation fails the rate comparability standard. The current average bill for a metered customer in Larkfield is 83% higher than in Sacramento. (Ex. 35, table 1.) Based on the revised figures provided by Cal Am for this GRC application, the proposed average bill for a metered customer in Larkfield will be 121% higher than in Sacramento. (Id.)

Cal Am concedes that the current rate differential between the Sacramento and Larkfield districts exceeds 25%. (Ex. 9, Tab 9, p. 45.) However, Cal Am qualifies its concession by stating that moving a \$2,000,000 portion Larkfield's revenue requirement only has the "minor" impact of increasing Sacramento's

revenue requirement by 6%. (Id. at 45-46.) A \$2,000,000 or 6% increase in Sacramento's revenue requirement is anything but "minor". Both metered and flat rate Sacramento ratepayers already face substantial increases in their bills of 27% and 42% respectively during the test year alone.¹⁵ An additional 6% increase only exacerbates these increases.

c) Water Supply

The DRA Guidelines require that the sources of water supply be similar in the districts subject to the consolidation proposal. (D.05-09-004, p. 8.) If one of the districts relies on a different water source type than the other district, future costs could change more in one district than the other. This could result in significantly divergent rates in the future even if present rates are similar. (Id.)

The proposed consolidation of the Sacramento and Larkfield districts fails to satisfy the water supply criterion. Although Sacramento and Larkfield both use a mix of purchased water and groundwater, this is not determinative since many water systems rely on a water supply mix that includes groundwater and purchased water. The water supply criterion requires consideration of the particular conditions of the water supply each district such as the specific condition of the aquifer, the nature of the groundwater basin and the cost and availability of purchased water. (Ex. 26, p. 12-4.)

Although both districts use a mix of purchased and ground water, the two districts confront very different water supply situations and sources. The Sacramento district faces serious water shortages due to groundwater contamination of some of its water sources. (Ex. 4, pp. 26-29.) Groundwater contamination has impacted the water supply in the Sacramento district and will continue to pose such a threat in the future. In order to address the water shortage, Cal Am plans to drill additional wells and secure purchased water from local

¹⁵ Additionally, the bills of metered and flat rate customers in Sacramento will increase another roughly 5% in each of the escalation years. (Ex. 15, sub-exhibit 7.)

purveyors. (Id.) Alternatively, the water supply in Larkfield faces no such serious threat from groundwater contamination.

Since the Sacramento and Larkfield districts face very different water supply situations and use distinct sources, the water supply criterion of the DRA Guidelines has not been met.

d) Operations

The DRA Guidelines specify that the districts to be consolidated should be operated in a similar manner. (D.05-09-004, p. 8.) Cal Am states that the Sacramento and Larkfield districts meet this criterion because they are managed by the same personnel and share a billing system. (Ex. 9, Tab 9, p. 46.) DRA does not contest this assertion. However, DRA notes that this is the only of four criteria of the DRA Guidelines that Cal Am's consolidation proposal has met.

e) Subsidization

The DRA Guidelines also state that no water districts should be combined for the express purpose of having one district subsidize another. (D.05-09-004, p. 8.) However, if Cal Am's consolidation proposal is adopted, Larkfield ratepayers will be substantially subsidized by Sacramento ratepayers--indeed this subsidization is the primary effect of the consolidation proposal.

Under Cal Am's consolidation proposal, Sacramento ratepayers would overtly subsidize Larkfield ratepayers. The proposed subsidy is clear from the bill comparisons. After consolidation, the average bill for a Larkfield ratepayer's in 2008 would drop from \$85.97 to \$32.86, **a decrease of \$53.11 or 94.55%**. (Ex. 15, sub-exhibit 4.) The average bill of a metered Sacramento ratepayer would rise from \$30.49 to \$40.37, an increase of \$9.88 or 32.42%. (Ex. 15, sub-exhibit 7.)

Sacramento ratepayers would pay an additional \$1.84 million in 2008 and that subsidy would increase over the two escalation years. (Ex. 35, table 1.) Cal Am's consolidation proposal would require Sacramento ratepayers to contribute 59% of Larkfield's estimated 2008 revenue requirement. (Id.) Each Larkfield

ratepayer essentially would be receiving a monthly check for \$51.11 paid by Sacramento ratepayers. While certain Larkfield ratepayers may require some financial assistance, their individual situations do not justify a district-wide subsidy, especially when the burden of this subsidy would fall on all ratepayers in Sacramento, including some low income customers.

Since Sacramento ratepayers will not be receiving any benefit from the increase in their bills, Cal Am's consolidation proposal is properly viewed as a pure subsidy contrary to Commission practice and the DRA Guidelines.¹⁶

f) Conclusion

Cal Am's application fails to satisfy three out of the four criteria of the DRA Guidelines as well as the requirement that districts would not be consolidated for the purpose of subsidization. Therefore, Cal Am's proposal does not enjoy any presumption of reasonableness. Despite Cal Am's position that the DRA Guidelines are no longer relevant, they are still valid and establish a useful evaluation guideline and yardstick against which consolidation applications can be measured.

Since Cal Am has not satisfied the DRA Guidelines, the review must then focus on the whether or not Cal Am has demonstrated that its consolidation proposal is in the public interest. Below DRA will demonstrate that Cal Am has failed to satisfy this burden.

B. Burden Of Proof

Cal-Am's proposal fails to satisfy three out of the four DRA Guidelines. Therefore, Cal Am has failed to make a *prima facie* case for consolidation. As a result, Cal Am has the burden of establishing that the consolidation proposal serves the public interest and its advantages outweigh its disadvantages. Cal Am

¹⁶ Cal Am's own witness acknowledged that Sacramento district will not receive any benefits from the consolidation. (Cal Am/Stephenson, 4 RT 158.)

has failed to meet this burden. Public Utilities Code (PU Code) § 454 reads in part:

... no public utility shall change any rate or so alter any classification, contract, practice, or rule as to result in any new rate, except upon a showing before the commission and a finding by the commission that the new rate is justified. (PU Code § 454.)

Moreover, Cal Am must show that the relief it seeks is justified on the basis of clear and convincing evidence.

It is well settled regulatory law that a utility seeking an increase in rates has the burden of showing by clear and convincing evidence that it is entitled to such increase. Any doubts must be resolved against the party upon whom rests the burden of proof. If the utility does not sustain the burden of satisfying the Commission that the proposed increase is justified, the application will be denied. (Pacific Telephone and Telegraph Company, D.0647, A.58233 (1979), 2 CPUC 2nd 89, 98)

Cal Am's proposal will increase Sacramento's rates; thus, it must meet a "clear and convincing evidence" standard for the burden of proof. This standard is more stringent than the preponderance of evidence standard. "Clear and convincing proof" means proof by evidence that is clear, explicit and unequivocal; that is so clear as to leave no substantial doubt; or that is sufficiently strong to demand the unhesitating assent of every reasonable man." (Jefferson, California Evidence Benchbook, (2d ed. 1990 supp.) Section 45.1, p. 602.)

Ultimately, this is a heavy burden, and one that Cal Am alone must bear. The Commission has explained,

[a] fundamental principal involving public utilities and their regulation by governmental authority that the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, its Staff, or any interested party, or protestant, to prove the contrary. (Suburban Water Co., D.65210, 60 CPUC 768 (1963) rev. denied, SoCalGas Co., D.60615, 58 CPUC 57 (1960); So. Counties Gas Co.,

D.60614, 58 CPUC 27 (1960); Citizens Utilities Co.,
D.48778, 52 CPUC 637 (1953).)

DRA urges the Commission to bear this burden of proof in mind as it weighs the quality of Cal Am's evidence and its justification for consolidation of the Sacramento and Larkfield districts.

C. Cal Am's Consolidation Proposal does not Serve the Public Interest

Cal Am asserts its consolidation proposal serves the public interest because it reduces the rates for Larkfield ratepayers, allocates cost of service over a broader customer base, reduces administrative and regulatory costs and improves affordability. (Ex. 9, Tab 9, p. 40.) Cal Am also claims that the situation in this proceeding is similar to that in D.00-06-075, where the Commission authorized a consolidation request because it served the public interest.

DRA disagrees with Cal Am's assertion. Consolidation will have a minimal effect on administrative and general expenses. While it will lower the cost of water service to Larkfield customers, this subsidy is only accomplished by violating numerous long-standing Commission ratemaking principles including: 1) breaking the link between rates and cost of service and 2) inequitably burdening Sacramento district ratepayers. Lastly, D.00-06-075 is distinguishable from this case because Larkfield is not an impoverished district.

1. Consolidation does not serve the public interest because it breaks the link between rate and cost of service

Cal Am's consolidation proposal fails to adhere to the Commission's cost of service principle as required in Section 701.10 of the Public Utilities Code. Section 701.10(f) requires that the rates and charges established by the Commission for water service shall be based on the cost of providing the water service. (PU Code § 701.10.) Under Cal Am's consolidation proposal, 59% of Larkfield's cost of service will be shifted to Sacramento ratepayers. (See Ex. 35, table 1.)

Larkfield ratepayers will be paying far less than their actual cost of service, while Sacramento ratepayers will be in effect transferring a portion of their bills to Larkfield customers, i.e., paying for service they receive no benefit from. (Cal Am/Stephenson, 4 RT 158.)

In addition, the consolidation proposal breaks the link between rates and cost of service for water. A break in that link will have a tremendous effect on the signal sent to ratepayers regarding the costs of their water use.

[I]f we break that link, customers in high cost areas are going to be getting the signal to use more water, and it is the opposite of what we want to send. I mean if water is precious and the supply is limited, we don't want to lower the price when it is a high cost area, otherwise we will be subsidizing housing developments in the desert. (DRA/Brooks, 4 RT 231-232.)

In a time when California faces an ever increasing population and a dwindling supply of water, it is imperative that the Commission maintain the link between rates and cost of service. When analyzed from a broader public policy perspective, consolidation could actually have a negative impact on the Commission's efforts to promote conservation. Unless ratepayers receive a clear signal regarding the cost of their water use, the water supply will become increasingly insufficient for the needs of Californians.

**2. Consolidation is not in the public interest
because it inequitably burdens Sacramento
ratepayers**

When evaluating whether Cal Am has satisfied its burden that consolidation is in the public interest, the Commission must consider the public interest of both the Sacramento and Larkfield districts. Ratepayers in the Sacramento will be directly subsidizing the cost of water for customers in the Larkfield without receiving any benefit. (Cal Am/Stephenson, 4 RT 158.) The consolidation proposal is not in the public interest because it inequitably burdens Sacramento ratepayers and inappropriately subsidizes Larkfield customers. Due to this

inequitable burden, the Commission should reject Cal Am's consolidation proposal.

As discussed previously, consolidation will provide Larkfield residents, on average, a 41.5% decrease over their current monthly bill. (Ex. 15, sub-exhibit 4.) When taking into consideration that Larkfield ratepayers were facing a 53.05% increase in their monthly bills without consolidation, consolidation provides Larkfield ratepayers with an astounding overall **reduction of 94.55%**. (Id.)

Without consolidation, Sacramento ratepayers will experience a 27.39% increase in their water bills in the 2008. (Id., sub-exhibit 7.) With consolidation, they will be facing a 32.4% increase in 2008. (Id.) Although the overall dollar amounts Sacramento ratepayers will be paying to subsidize Larkfield are not large, they exacerbate the significant rate increase Sacramento ratepayers face in this GRC regardless of consolidation.

Sacramento County has nearly twice the percentage of families living below the poverty level than Larkfield. (Ex. 36, p. 1; Ex. 37, p. 1.) The 2000 Census indicates that 10.3% of all families in Sacramento County were living below the poverty line, compared with only 5.4% of families in Larkfield area. (Id.) Cal Am has approximately 58,000 customers in its Sacramento district, and only about 2,400 customers in Larkfield. Consolidation would essentially require the roughly 5,800 families living below the poverty line in the Sacramento district to help subsidize the approximately 2,280 families living above the poverty line in Larkfield. (Id.)

Over the long-term, consolidation will increase the burden on Cal Am's impoverished ratepayers in Sacramento because their water rates will have been artificially inflated by the Commission so that Cal Am's Larkfield customers will enjoy subsidized water. (Id.)

In the past DRA has supported subsidization of impoverished communities because the subsidies granted were consistent with the Commission's public policy goal of making water affordable to all communities. However, this

consolidation proposal would have the opposite effect, burdening a district with a substantial number of impoverished residents with the task of subsidizing a district with a relatively affluent population.

3. The Southern California Water Company decision (D.00-06-075) is distinguishable from the case at hand

In support of its rate consolidation proposal, Cal Am cites three settlements and one Commission decision. (Ex. 9, Tab 9, p. 45.) Although Cal-Am acknowledges that settlements have no precedential value, it still discusses the settlements in its testimony. Since settlements have no precedential value, they must not be considered in this proceeding. (See Rules 12.5) Cal Am cites D.00-06-075, in which Southern California Water Company (“SCWC”) sought and received authority to consolidate various districts into a region-wide tariff. (D.00-06-075, 2000 Cal. PUC LEXIS 1114, pp. *1-2.)

D.00-06-075 presented a completely different situation and is distinguishable from the case at hand. The Commission’s approval of that consolidation application was “[b]ased on the compelling need for rate relief in some of the smaller districts in the company's Region III.” (2000 Cal. PUC LEXIS 1114, *1) Moreover, the Commission stated:

Our approval of this application does not establish a generic policy. Rather, we regard single tariff pricing in this instance as an acceptable regulatory tool that is not incompatible with traditional cost-of-service ratemaking . . . [I]n the future, we will continue to consider proposals for cost averaging on a case-by-case basis, with the burden on the proponents of such plans to show substantial benefits in the public interest. (*Id.* at *45, emphasis added.)

In D.00-06-075, the Commission found that there was a compelling need for rate relief for some of the smaller, more impoverished districts.¹⁷ Although SCWC’s consolidation proposal failed to satisfy the DRA Guidelines, SCWC met

¹⁷ See also Commissioner Bilas’ dissent to the D.00-06-075.

its burden in showing that the consolidation proposal was in the public interest. D.00-06-075 involved impoverished districts facing major rate shock. The Calipatria-Niland and Desert districts were arguably impoverished and the proposed rate increase was huge (for example, the Calipatria district had forecasted rates going from \$139.49 a month to \$322 a month in the span of three years). (See D.00-06-075, p. *36 & Comm'r Bilas dissent, p. *56.)

In sharp contrast to the Calipatria-Niland and Desert districts, Larkfield is not an impoverished district. (See Ex. 36 and 37.) The 2000 census reports that in 1999 the median family income in the Larkfield area was over \$60,000. (Ex. 36, pg. 1.) Furthermore, Cal Am has not provided evidence that the Larkfield district is an impoverished district or that its ratepayers need rate relief.

The maximum amount that rates can increase in Larkfield is from \$56.17 to \$85.97 or 53.05%. (Ex. 15, sub-exhibit 4.) DRA acknowledges that this is a substantial increase. However, Larkfield's present and future rates do not even approach the levels of those faced by Calipatria, an impoverished community. It must also be noted that the actual increase proposed by Cal Am in its revised filing will be considerably less than 53.05% due the partial settlement between DRA and Cal Am.

Lastly, most of the ratepayers the Commission heard from in D.00-06-075 supported the consolidation. (See D.00-06-075, Finding of Fact 14.) However, public opinion in both Sacramento and Larkfield is strongly opposed to consolidation. During Public Participation Hearings in Larkfield, an overwhelming majority of the speakers were vehemently opposed to Cal Am's consolidation proposal. When a show of hands was requested to indicate who of those in attendance were opposed to consolidation, 98% of the attendees raised their hands. (PPH, 2 RT 70.)

Clearly, Commission precedent and sound public policy does not support Cal Am's consolidation proposal. The various factual differences in the current application undermine the Commission's previous rationale in approving

consolidated rates when the applicant's consolidation proposal failed to meet the criteria of the DRA Guidelines.

D. Consolidation is not Justified by the Water Action Plan

Cal Am justifies its consolidation proposal by claiming it is called for by the Water Action Plan ("WAP"). (Ex. 9, Tab 9, pp. 38-39.) The sixth objective of the WAP is to "Set Rates Balancing Investment, Conservation, and Affordability." (WAP, p. 4.) The second action of this objective calls for the development of "policies to subsidize high cost areas, either through some variation of a 'High-Cost Fund' or through consolidation of districts or rates." (Id at 20.)

The WAP is a guideline, not the product of a Commission decision or resolution. The WAP does not establish policy, rather it identifies major policy issues concerning the regulation of investor owned water utilities and suggests possible solutions. The purpose of the WAP is to initiate a process where the Commission explores "innovative solutions" to these major policy issues. (Id at 3.) This is evidenced by the ongoing Order Instituting Investigation ("OII") I.07-01-022, which was initiated in response proposals to achieve the second objective of the WAP.¹⁸

Consolidation is one way under the current circumstances to achieve affordability, but it is not the most effective or equitable solution. (DRA/Brooks, 4 RT 2216-217.) Other solutions exist that will not only provide affordability, but also target those Larkfield ratepayers who are in most need of assistance without inequitably burdening Sacramento ratepayers. The Commission has utilized many other programs that specifically assist the ratepayers who are in need of assistance. (DRA/Brooks, 4 RT 220-222.) For example, Low Income Ratepayer Assistance ("LIRA") programs, which will be available for Larkfield, can provide aid to

¹⁸ The second objective is to Strengthen Water Conservation Programs to a Level Comparable to those of Energy Utilities.

qualifying families. The CAPS Standard Procedure allows only a yearly maximum increase of a 50%. (Ex. 26, p. 12-6.) Additionally, the conservation rate design will lower the bills of customers who use less water and provide incentive to decrease their bills by reducing water use.

Furthermore, Larkfield does not face the affordability issues of other impoverished districts. Larkfield is not an impoverished district comparable to Lucerne where a large percentage of the population would qualify for low income programs. (DRA/Brooks, 4 RT 221.) Unlike Larkfield, the Sacramento district is facing increased rates due to capital improvement projects needed to deal with ongoing groundwater contamination issues.

E. Public Opinion is Clearly Against Consolidation

An important factor in the Commission's consideration of Cal Am's consolidation proposal should be public opinion. Public opinion in both the Sacramento and Larkfield districts is clearly against consolidation.¹⁹

In addition to the CPUC's required customer notice of rate adjustments, Cal Am also provided Larkfield customers with a series of direct mailings detailing the savings customers could expect under consolidation.²⁰ (See generally Ex. 47.) Cal Am also held public meetings in Larkfield specifically on the topic of consolidation. During the meetings, residents also received information on the effects of consolidation on their rates. (Id.)

Despite these aggressive outreach efforts, most Larkfield ratepayers who attended the public meetings were opposed to consolidation, as admitted by Cal

¹⁹ Cal Am mistakenly asserted in its response to DRA's protest that nearly five hundred customers signed petitions supporting consolidation. Upon closer review of the petitions, it was revealed that many of the signatures came from the same household. As admitted by Cal Am's witness, each household counts as one customer. (Cal Am/Stephenson, 4 RT 154.) Of a total of 471 signatures, 34 were from the same household, so the actual number of households who signed the petition is 437, less than initially stated by Cal Am. (Cal Am's Response to DRA's Protest.)

²⁰ Much of the information distributed to Larkfield ratepayers by Cal Am presented an either-or choice, high rates as one option and consolidation with lower rates as the other. (Ex. 26, p. 12-7.)

Am's own witness during cross examination.²¹ (Cal Am/Stephenson, 4 RT 154.) During Public Participation Hearings in Larkfield when a show of hands was requested to indicate those in attendance who were opposed to consolidation, 98% of the attendees raised their hands. (PPH, 2 RT 70.) Additionally, it should be noted a group representing Larkfield ratepayers are so vehemently opposed to consolidation that they intervened in this GRC proceeding.

Sacramento ratepayers are also staunchly opposed to consolidation. Nearly all of those who spoke at the two Sacramento Public Participation Hearings were adamantly opposed to consolidation. (Cal Am/Glover, 6 RT 429.) The Commission's Public Advisor's Office also has received a large number of letters and emails in opposition to consolidation. (Ex. 26, p. 12-7.)

The Commission is charged with ensuring safe, reliable utility service at reasonable rates. They do this on behalf of California ratepayers. The people who would benefit from consolidation in this GRC are largely against it. Ratepayers in both the Sacramento and Larkfield districts have clearly voiced their opinions against consolidation. Their voices should be heard.

F. Cal Am's Alternative Consolidation Proposal Still Problematic

Cal Am put forth an alternate consolidation proposal in the event the Commission found that the primary proposal shifted too much of Larkfield's revenue requirement too quickly. (Ex. 9, Tab 9, p. 38.) The alternate proposal was to hold:

...the rates in Larkfield constant until they are approximately equal to those for metered customers in Sacramento, with the

²¹ In sharp contrast to the efforts made in Larkfield, Cal Am's outreach efforts in Sacramento were much less aggressive. In fact, Sacramento ratepayers never received specific information about the consolidation proposal via personal mailings or door-to-door canvassing. (Cal Am/Glover, 6 RT 429.) Since Sacramento ratepayers make up the vast majority of those affected by the proposed consolidation, it seems, as a matter of public policy, that they should have been the district receiving the most information about the consolidation, not the other way around. Despite their limited knowledge and opportunities to express their views, Sacramento ratepayers who attended the public participation hearings predominantly opposed consolidation.

then calculated under recovered portion of the proposed revenue requirement being shifted to Sacramento and therein recovered as a part of the revenue recovery mechanism (rate design) in Sacramento. (Id.)

DRA also opposes the alternate consolidation proposal. Although the alternate proposal reduces the impact on Sacramento ratepayers, it is still problematic. All of the issues that concern the primary consolidation proposal apply to the alternate, albeit to a lesser degree. The alternate proposal fails to satisfy the DRA Guidelines and is a subsidy for a district that is not impoverished like the districts in D.00-06-075. Cal Am's alternate consolidation proposal is not in the public interest and opposed by the public. DRA recommends that the Commission reject Cal Am's alternate consolidation proposal.

VI. Administrative and General Expenses

DRA and Cal Am disagree on two accounts under Administrative and General Expenses ("A&G"), Employee Pensions and Benefits and Regulatory Expenses. The positions of DRA and Cal Am as to these two accounts differ in each of the four districts in this GRC.

A. Employees Pensions and Benefits

1. Sacramento District

Cal Am's estimate of \$1,256,066 for Employees Pensions and Benefits is based on a five-year average of years 2002 to 2006 escalated to 2007, then escalated to the Test Year 2008.

DRA's estimate is \$1,085,411. DRA used a four-year average of recorded years 2003 to 2006 then applied an escalation factor. DRA did not use recorded year 2002 to average this account because Cal Am did not provide sufficient explanation of the expense recorded for that year. (Ex. 25, pp. 4-2 to 4-3.)

The difference between the estimates is largely due to the use of different escalation factors. Cal Am projected its Group Insurance costs using an escalation factor of 8% for 2007, and an increase of 9% for 2008 based on historical trend

and other information. (Cal Am Sacramento district Exhibits A-D, & F, Exhibit A, Chapter 6.) DRA used the lower escalation factor CPI-U for Group Insurance as stated in D.04-06-018. (Id.)

Another reason for the difference between the estimates is a minor adjustment DRA made an adjustment to Cal Am's recorded amounts of years 2003 to 2006 for sub-account 504610.16 Employee awards for ratemaking purposes. (Id.) This adjustment removed costs associated with employee recognition awards. (Id.) DRA acknowledges that employees should be recognized for their work. However, these employee recognition awards are not necessary to operate the utility business and were inappropriately charged to ratepayers.

For the reasons above, DRA requests the Commission adopt its estimate for Employees Pensions and Benefits of \$1,085,411 for the 2008 Test Year for the Sacramento district.

2. Larkfield District

Cal Am's estimate of \$123,181 for Employees Pensions and Benefits is based on a four-year average of years 2003 to 2006. DRA's estimate is \$104,477. (Ex. 26, pp. 4-2 to 4-3.) DRA's analysis did not use recorded year 2002 to average for this account since Cal Am did not include breakdown of recorded data to analyze this given year. (Id.)

The difference between the estimates is largely due to the use of different escalation factors. Cal Am projected its Group Insurance costs using an escalation factor of 8% for 2007, and an increase of 9% for 2008 based on historical trend and other information. (Cal Am Larkfield district Exhibits A-D, & F, Exhibit A, Chapter 6.) DRA used the lower escalation factor CPI-U for Group Insurance as stated in D.04-06-018.

DRA's downward adjustment of two sub-accounts also results in some minor changes in DRA's estimate. Due to an unusual expense for 2004, DRA

used a three-year average of recorded years 2003, 2005 and 2006 for sub-account 504620.16 resulting in a reduction of \$1,156 from Employee Physical Expense. DRA also removed amount sub-account 504610.16 Employee awards by \$116. (Id.) This adjustment removed costs associated with employee recognition awards. (Id.) DRA acknowledges that employees should be recognized for their work. However, these employee recognition awards are not necessary to operate the utility business and were inappropriately charged to ratepayers.

For the reasons above, DRA requests the Commission adopt its estimate for Employees Pensions and Benefits of \$104,477 for the 2008 Test Year for the Larkfield district.

3. Coronado District

Cal Am's estimates for Employees Pension & Benefits were \$367,500 and \$374,500 for the Test Year 2008 and the Escalation Year 2009 respectively. DRA's estimates for Employees Pension & Benefits Expenses were \$342,300 and \$349,300 for the Test Year 2008 and the Escalation Year 2009 respectively. (Ex. 27, pp. 4-2 to 4-3.)

The difference between the estimates is due to the use of different escalation factors. Cal Am projected its Group Insurance costs using an escalation factor of 8% for 2007, and an increase of 9% for 2008 based on historical trend and other information. (Cal Am Coronado district Exhibits A-D, & F, Exhibit A, Chapter 6.) DRA's estimate used the ECOS' escalation factors for 2007, 2008 and 2009 respectively (3.2%, 1.8% and 2.1%). (Id.)

DRA requests the Commission adopt its estimates of \$342,300 and \$349,300 for the Test Year 2008 and the Escalation Year 2009 respectively for the Coronado district.

4. Village District

Cal Am's estimates for Employees Pension & Benefits of \$306,500, and \$312,300 for the Test Year 2008, and the Escalation Year 2009 respectively.

DRA's estimates for Employees Pension & Benefits were \$287,300 and \$293,200 for the Test Year 2008 and the Escalation Year 2009 respectively. (Ex. 28, pp. 4-2 to 4-3.)

The difference between the estimates is due to the use of different escalation factors. Cal Am projected its Group Insurance costs using an escalation factor of 8% for 2007, and an increase of 9% for 2008 based on historical trend and other information. (Cal Am Village district Exhibits A-D, & F, Exhibit A, Chapter 6.) DRA's estimate used the ECOS' escalation factors for 2007, 2008 and 2009 respectively (3.2%, 1.8% and 2.1%). (Id.)

DRA requests the Commission adopt its estimates of \$287,300 and \$293,200 for the Test Year 2008 and the Escalation Year 2009 respectively for the Village district.

B. Regulatory Expenses

1. Sacramento District

Cal Am's estimate of \$159,177 for regulatory expenses is based on the amortization of the prior Sacramento District GRC proceeding plus expenses estimated as the result of the present filing and processing of this application. DRA's estimate for year 2008 is \$125,808. DRA used the adopted amount of \$122,500 from the previous GRC and used DRA's Composite Escalation factor to escalate to test year 2008. (Ex. 25, p. 4-5.)

Since the amount for regulatory expenses is amortized over three years, Cal Am will receive \$159,177 for 2008, 2009, and 2010 respectively for a total of \$477,531. Although DRA acknowledges that there will be considerable regulatory expenses in preparation for and during a GRC proceeding, the regulatory expenses will be lower outside these time periods. However, Cal Am will receive \$159,177 for 2008, a year when regulatory expenses should be lower because Cal Am will

not be preparing for and participating in a GRC.²² Taking into account that the regulatory expense amount is amortized, supports DRA's contention that Cal Am's request is excessive and the Commission should adopt DRA's recommendation of \$125,808.

2. Larkfield District

Cal Am's estimate of \$42,000 for regulatory expenses is based on the amortization of the prior Larkfield District GRC proceeding plus expenses estimated as the result of the present filing and processing of this application. DRA's estimate for test year 2008 is \$13,600. DRA used the adopted amount of \$5,000 from the previous GRC and added \$8,333 for Cal Am's rate design expense. DRA used composite escalation factor to escalate year 2008. Cal Am's estimate is more than 800% over the amount of \$5,000 adopted in its last GRC.

Since the amount for regulatory expenses is amortized over three years, Cal Am will receive \$42,000 for 2008, 2009, and 2010 respectively for a total of \$126,000. Although DRA acknowledges that there will be considerable regulatory expenses in preparation for and during a GRC proceeding, the regulatory expenses will be lower outside these time periods. However, Cal Am will receive \$42,000 for 2008, a year when regulatory expenses should be lower because Cal Am will not be preparing for and participating in a GRC. Taking into account that the regulatory expense amount is amortized, supports DRA's contention that Cal Am's request is excessive and the Commission should adopt DRA's recommendation of \$13,600.

3. Coronado District

Cal Am's estimate for regulatory expenses was \$79,300 for the test year 2008. Using Cal Am's 2006 recorded amount of \$61,900 adjusted for inflation, DRA's estimate for regulatory expense was \$64,900 for the test year 2008. Prior

²² Some of the regulatory expenses required for a GRC include costs of: consultants, customer notices, and company labor preparing testimony. (Cal Am/Jordan, 5 RT 387-388.)

to 2005, Cal Am had minimal regulatory expenses. The 2006 recorded expenses, adjusted for inflation, provide Cal Am with an adequate level of regulatory expenses.

Since the amount for regulatory expenses is amortized over three years, Cal Am will receive \$79,300 for 2008, 2009, and 2010 respectively for a total of \$237,900. Although DRA acknowledges that there will be considerable regulatory expenses in preparation for and during a GRC proceeding, the regulatory expenses will be lower outside these time periods. However, Cal Am will receive \$79,300 for 2008, a year when regulatory expenses should be lower because Cal Am will not be preparing for and participating in a GRC. Taking into account that the regulatory expense amount is amortized, supports DRA's contention that Cal Am's request is excessive and the Commission should adopt DRA's recommendation of \$64,900.

4. Village District

Cal Am's estimate for regulatory expenses was \$79,400 for the test year 2008. Using Cal Am's 2006 recorded amount adjusted for inflation, DRA's estimate for regulatory expenses was \$45,900 for the test year 2008. Prior to 2005, Cal Am had minimal regulatory expenses. The 2006 recorded expenses, adjusted for inflation, provide Cal Am with an adequate level of regulatory expenses.

Since the amount for regulatory expenses is amortized over three years, Cal Am will receive \$79,400 for 2008, 2009, and 2010 respectively for a total of \$238,200. Although DRA acknowledges that there will be considerable regulatory expenses in preparation for and during a GRC proceeding, the regulatory expenses will be lower outside these time periods. However, Cal Am will receive \$79,400 for 2008, a year when regulatory expenses should be lower because Cal Am will not be preparing for and participating in a GRC. Taking into account that the regulatory expense amount is amortized, supports DRA's contention that Cal

Am's request is excessive and the Commission should adopt DRA's recommendation of \$45,900.

VII. CONCLUSION

For all the foregoing reasons, and for the reasons set forth in its testimony, DRA respectfully requests that the Commission adopt its recommendations and disallow Cal Am's unjustified requests regarding Cost of Capital, ISRS, Consolidation of the Sacramento and Larkfield districts and A&G Expenses.

Respectfully submitted,
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June 28, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **“OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES”** in **A.07-01-036, et al** by using the following service:

☒ **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

☐ **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on June 28, 2007 at San Francisco, California.

/s/ HALINA MARCINKOWSKI

Halina Marcinkowski

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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